

BEFORE  
THE PUBLIC SERVICE COMMISSION OF  
SOUTH CAROLINA  
DOCKET NO. 90-626-C - ORDER NO. 91-811  
SEPTEMBER 26, 1991

IN RE:	Application of Southern Bell	)	ORDER ADDRESSING
	Telephone & Telegraph Company	)	PETITION FOR
	to Avail itself of Incentive	)	REHEARING,
	Regulation of its Intrastate	)	RECONSIDERATION
	Operations.	)	AND/OR CLARIFICATION

This matter comes before the Public Service Commission of South Carolina (the Commission) by way of a Petition for Rehearing, Reconsideration and/or Clarification of Order No. 91-595 filed by Southern Bell Telephone & Telegraph Company (Southern Bell) in the instant matter.

Southern Bell's Petition alleges several points of error on the part of the Commission. First, Southern Bell takes issue with the Commission's finding concerning the cost of equity capital of 13.00%. Specifically, Southern Bell disputes the Commission's finding that witness Avera, testifying on behalf of Southern Bell, relied on only one financial model, the Capital Asset Pricing Model (CAPM) to develop the cost of equity capital recommendation for Southern Bell. Southern Bell contends that Dr. Avera did not rely on only one financial model.

A review of Dr. Avera's testimony reveals that Southern Bell misinterprets the testimony of its own witness. Dr. Avera

determined that the discounted cash flow (DCF) method was inapplicable to Southern Bell's rate of return analysis, therefore, he relied on the CAPM model of which the risk premium analysis is a component. Dr. Avera's statement of the inapplicability of the DCF method was stated in Volume 2, page 107 of the transcript of the proceedings before the Commission. While Dr. Avera may have given testimony concerning the Company's operation and its competitive environment, the only financial model used and relied upon in his analysis is the CAPM method. The Commission's findings in that regard are completely supported by the record.

Secondly, Southern Bell contends that the use of the term "vagaries" by the Commission in describing Dr. Avera's testimony is derogatory and reveals a predetermined bias. This, too, is a misinterpretation of the Commission's Order. "Vagaries" is not nor was it intended to be a derogatory term. Therefore, since there was no intent to use a derogatory term, Southern Bell's assertion that the Commission had a predetermined bias against Southern Bell's position is misplaced. Certainly, the rate of return found to be appropriate in this case of 13.00% on equity is within the range of returns recommended by the witnesses in this case and do not, as Southern Bell would contend, constitute arbitrary and capricious behavior and is not so low as to result in the confiscation of Southern Bell's property in violation of the United States' and South Carolina's Constitutions.

Also, Southern Bell contends that the Commission's reasoning in rejecting Dr. Avera's recommendation on the purported grounds

that it is improper or nonpersuasive to use BellSouth's cost of equity as a proxy for that of Southern Bell. Again, Southern Bell misconstrues the language of the Commission's Order. What the Commission's Order said was that witness Avera used only one Company, BellSouth, as a proxy for Southern Bell's operations in South Carolina. The Commission went on to note that both witnesses Legler and Rhyne used other proxies in addition to BellSouth. Dr. Legler used as a sample several independent telephone companies and the regulated Bell operating companies. Dr. Rhyne also used the RBOC's as a proxy for Southern Bell's intrastate telephone operations within South Carolina. The implicit finding of the Commission then, is that other proxies, in addition to BellSouth, make a more reliable proxy to use in determining the appropriate rate of return on equity for Southern Bell. The Commission went on to find, that because of the lack of use of another methodology to verify the results obtained through Dr. Avera's analysis and because no other proxy besides BellSouth was used as a sample, the Commission did not rely on the recommendation of Dr. Avera for the appropriate cost of capital. Neither the Commission's reasoning, nor the analysis of Drs. Rhyne and Legler are flawed. Accordingly, there is no need to either rehear or reconsider this portion of the Commission's Order dealing with the rate of return on equity.

Southern Bell next contends that the Commission's reliance on Part 32.2000(g)(4) and (5) of the Uniform System of Accounts is, according to the Company, a penalty imposed on the Company's shareholders for their bringing the state of the art

telecommunications services to South Carolina. This so-called penalty imposed by the Commission, according to Southern Bell, is inconsistent with the public interest. Southern Bell states that the Commission Staff removed from the depreciation reserve surplus the remaining portion of the undepreciated investment in outdated "step-by-step" and "cross-bar" switching technology which had been replaced with more modern equipment. Southern Bell additionally states that no other party concurred with Staff's proposal.<sup>1</sup> Southern Bell points out that witness Killingsworth's testimony is more persuasive than the Commission Staff's and the results of the Commission's decision leads to the confiscation of the Company's property and is so arbitrary and capricious as to warrant reversal.

The Commission has reviewed the adjustment to "step-by-step" and "cross-bar" retirements, as well as, the record in this matter. The Commission Staff contended, and the Commission agreed, that the retirement of the "step-by-step" and "cross-bar" assets was extraordinary and that it met the three criteria of such retirement as defined in Part 32.2000(g)(4), and (5) of the Uniform System of Accounts. The Order adequately addresses the criteria in that it recognizes that the rates used for depreciation of these assets appear to have been inadequate when they were agreed upon in a three-way meeting between the Company, the Commission Staff, and the FCC when such rates were set. Therefore, the impending retirements could not have been adequately considered. Secondly,

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1. The Commission notes that no other party besides Southern Bell opposed Staff's adjustment.

the charging of the retirement against the reserve unduly depletes that reserve. Thirdly, the extraordinary retirement of these assets was unusual in nature.

This Commission has been consistent in cases involving other companies faced with similar circumstances. See Order No. 86-454, Docket No. 86-99-C, Application of Farmers Telephone Cooperative, Inc. for Approval of Extraordinary Retirement with Yearly Amortization of Central Office Equipment. Such procedures used in these cases involve the deferring of the remaining undepreciated balance and the write-off of such a balance over a period of years. A write-off in this manner would be "above the line" for ratemaking purposes, while the unamortized balance would not get a rate of return treatment. The Commission, by adopting such an adjustment, is attempting to recognize the necessity of a "sharing" between the Company's shareholders and its ratepayers. By allowing the Company to include the write-off of the undepreciated balance over a period of years, the Company will recover the cost of the asset from the ratepayer, while not allowing the unamortized balance to receive rate of return treatment shares that cost with the shareholder. This is not a penalty being placed on the Company, rather it is a recognition that the ratepayer, while receiving the benefit of state of the art technology, would also be paying a return on the old, obsolete equipment, as well as the new equipment. The Company, in that case, would be receiving all the benefit, especially for equipment not used and useful. The Commission does not think this is fair from a ratemaking perspective and has

determined that a sharing of the cost of the retired assets is a more appropriate method of handling this cost.

Southern Bell also contends that the Commission's disallowance of a \$408,988 expense associated with the Palmetto Seed Capital Fund is in error. Southern Bell takes issue with the Commission's finding that the contribution is classified as a charitable contribution. The Commission points out that on page 23 of Order No. 91-595, the Commission's basis for denying the expense was that it was "more akin to a charitable contribution," and that it is possibly a non-recurring item which would require elimination to normalize the test year. The Commission did not directly find that the contribution was a charitable contribution, rather, the type of contribution to the Palmetto Seed Capital Fund was similar to a charitable contribution. Additionally, the fact that no witness could determine if a like contribution was going to be made in the future, or that if any contribution was to be made to this fund, was another reason for denying the inclusion of this contribution. To address Southern Bell's assertion that there was no legal requirement that the Company show a direct benefit to its ratepayers at the instant a dollar is spent, the Commission did not specifically rely on the question of benefit to the ratepayers in denying the inclusion of the expense. However, Southern Bell's analogy used in its Petition is inappropriate. Southern Bell contends that research into fiber optic cable and digital and optical switching technologies is research not unlike the Company's efforts at economic development which are included "above the line"

even though no direct benefit might be instantly ascertainable. The difference between a contribution to the Palmetto Seed Capital Fund and telecommunications technology is very clear. First, there has been no assertion made that the contribution to the Palmetto Seed Capital Fund was for the improvement or development of telecommunications in South Carolina. Secondly, the Company's research into telecommunications technology is something that will benefit its ratepayers. It is certainly debatable whether or not a contribution to the Palmetto Seed Capital Fund, which could potentially benefit certain aspects of the State, would directly benefit any of Southern Bell's ratepayers. Therefore, the Commission's decision to deny this contribution is based on the substantial evidence and fully supported by the facts of this case.

The Company takes issue with the Commission's treatment of Hurricane Hugo related expenses. Southern Bell's witness Killingsworth disagreed with the testimony of Staff Witness Ellison in this matter. The Commission allowed the Company to recover all appropriate costs associated with Hurricane Hugo from the ratepayers, except that any carrying charges on the unamortized deferred balance would not be allowed. Staff did not include Hurricane Hugo deferred charges of \$9,540,735 in rate base. The Commission did, however, allow this amount to be amortized over only a two-year period. The Commission's liberalized write-off of only two years reflects the Commission's recognition that this amount should be properly shared between the Company's shareholders and its ratepayers, but giving credence to the impact of the

devastation of Hurricane Hugo to the Company. The Commission does not consider Hurricane Hugo costs to be solely a ratepayer expense. The Commission does not assure that the shareholder will be insulated from all risks associated with operating the Company through regulation. By not allowing a return on the unamortized portion of Hurricane Hugo deferred charges, the Commission appropriately shares the risk between the shareholder and the ratepayer. This is a well-reasoned approach to a peculiar situation and is not, as the Company contends, arbitrary, capricious and not in concert with the record. The testimony of witness Ellison and the Commission's previous decision in Docket No. 89-610-W/S supports the Commission's adjustment concerning Hurricane Hugo.

Southern Bell also contends that the Commission's definition of "earnings" under the plan is in error. According to the Company, it interprets Commission Order Nos. 90-849 and 90-1009 to allow it to earn up to and including 16.50% on equity under the benchmark approved by the Commission or, 250 basis points above the 14.00% sharing threshold. Southern Bell contends that the definition of earnings adopted by the Commission in Order No. 91-595 was "invented" by the Staff. Nothing is further from the truth. The Commission, in determining that the Company's earnings are determined before they are applied to the plan, relied on its findings in Order Nos. 90-849 and 90-1009. The Commission did not ignore witness Farmer's testimony in this proceeding, rather, the Commission, through witness Farmer's testimony as well as that of



Southern Bell witnesses became aware that there was a dispute on the record concerning when the earnings were to be determined. The Commission determined that the earnings of the Company would be determined before sharing, while the Company contends that the Company's earnings should be determined after sharing. The Company merely disagrees with the Commission, and the record supports the Commission's determination that Southern Bell's earnings would be evaluated before the sharing or retention of earnings are applied to the plan. The Commission continues to be of the opinion that the earnings sharing plan is not a part of a telephone utility's normal financial obligation that must be "paid" before its earnings may be properly calculated. Southern Bell's mere disagreement is not sufficient for the Commission to reconsider or rehear this matter.

Southern Bell next takes issue with certain of the measures of productivity determined by the Commission to be an appropriate guideline in this matter. Specifically, the Company takes issue with the proposed measurement of "cost per access line." According to the Company, the analysis of this account should be net of depreciation. Again, there appears to be some misconception on the part of the Company of Order No. 91-595. What the Order specifies is that the operating expenses would be depicted on a cost per access line basis. This would not be a composite number, but the individual operating expense balances such as circuit equipment (Account No. 6232), station apparatus (Account No. 6311), land and building (Account No. 6121), depreciation (Account No. 6561), etc., would be divided by the number of access lines to determine each

operating expense account on a cost per access line basis. As noted, depreciation would be one account that would be depicted in this manner. According to the testimony of Witness Walsh, the balances would be shown including inflation and with inflation eliminated. Similarly, exogenous factors would be eliminated from each account's computations. The Company's disagreement with the plant non-specific expense and total plant in service ratio is likewise misunderstood. The Commission intends to receive a list of plant non-specific expenses such as power expense, testing expense, and depreciation over the total plant in service amount. Depreciation and amortization would be a part of the comparison. Again, it is the individual account analysis, not a composite figure that the Commission is seeking.

Southern Bell contends that Guideline No. 8 which requires the dividend payout ratio is impossible for the Company to provide. The Commission hereby amends its Guideline No. 8 to require that the Company provide a comparison of cash flows which reflect the flow of funds from Southern Bell South Carolina to Consolidated Southern Bell.

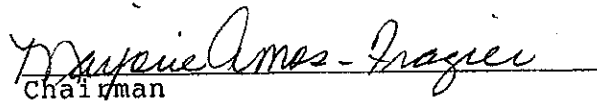
Having addressed the issues raised by Southern Bell in the instant Docket, the Commission has determined that the Company's request to rehear or reconsider the alleged errors asserted by Southern Bell should be denied. However, as noted herein, the Commission has clarified certain aspects of Order No. 91-595. Order No. 91-595 is clarified to the extent noted herein. Further, Order No. 91-595 is amended as to guideline number eight to require

the following information:


Provide a comparison of the cash flows which reflect the flow of funds from Southern Bell - South Carolina to Consolidated Southern Bell.

IT IS SO ORDERED.

BY ORDER OF THE COMMISSION:

  
Chairman

ATTEST:

  
Executive Director

(SEAL)